Nos. 824-825.

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1943.

KATIE M. HOWELL, *Petitioner*,

v.

COMMISSIONER OF INTERNAL REVENUE.

ESTATE OF J. H. HOWELL, Deceased, *Petitioner*,

v.

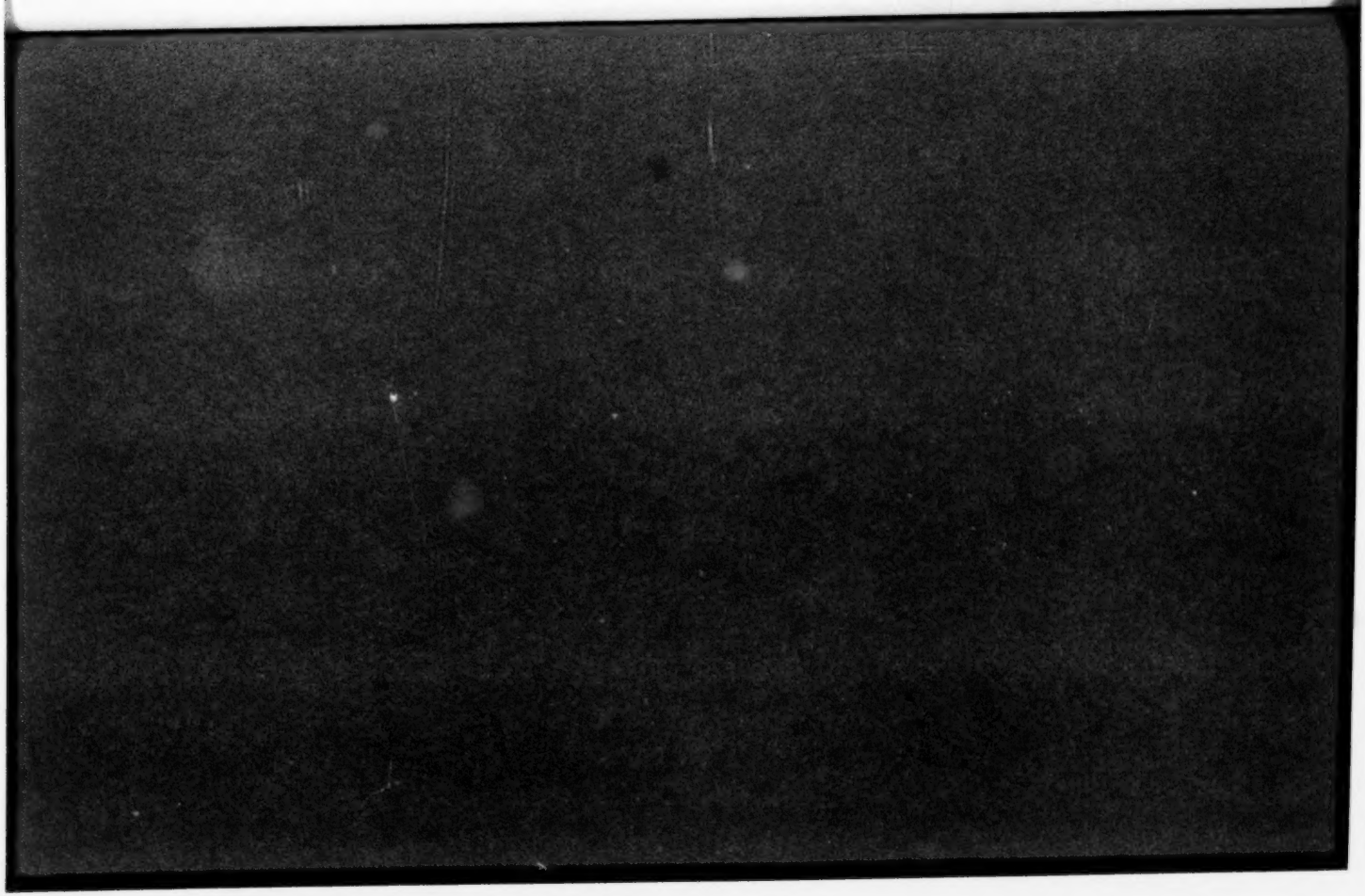
COMMISSIONER OF INTERNAL REVENUE.

On Petition for Writs of Certiorari to the United States Circuit Court of Appeals for the Fifth Circuit.

PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

ROBERT ASH,
Munsey Building,
Washington, D. C.,
Attorney for Petitioner.

PRESS OF BYRON S. ADAMS, WASHINGTON, D. C.



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PETITIONER'S REPLY TO RESPONDENT'S BRIEF IN OPPOSITION.

Respondent's brief is predicated entirely on the assumption that from October 6, 1937, until November 16 or 17, 1937, Howell owned nothing which was salable.

That Howell did own something and that petitioner's position is correct is shown by what actually happened in

this case. On October 26, 1937, Howell transferred an undivided three-fourths interest in the "acreage" to Consolidated Oil Company for $5,000.00 in cash, and Consolidated assumed all the obligations under the contract, including the drilling of the "obligation" well. (R. 52, 53.) It is plain nonsense to say that Howell did not own the "economic interest" at that time. Consolidated certainly thought so when it paid $5,000.00 cash and undertook to drill a well 4,000 feet deep. Yet the respondent argues that Howell owned nothing until the well was started by Consolidated.

At all times from October 6, 1937, Howell owned the only thing of value involved—i.e., the right to enter upon and exploit the land. The fact that he had to pay for that right later does not detract from his title to it.

Conflict with Burnet v. Harmel, 287 U. S. 103.

The respondent's brief (p. 9) states the *Harmel* case is not applicable because that case involves "*what* economic interests pass to a lessee of oil and gas lands, rather than *when* those interests pass."

Petitioner insists that *what* economic interest Howell acquired on October 6, 1937, is the point involved in this case. If, as petitioner contends, the thing involved is the "economic interest" as defined by this Court in numerous oil and gas cases, the question of *when* that interest passed is automatically disposed of. If the thing involved is the right to enter upon the land and exploit it for oil ("economic interest") justice and adherence to this Court's decisions demand that the writs issue.

In the *Harmel* case, the Government successfully contended that, in determining the capital gains question involved, it was not "bound by the decision of the Texas courts that leases of oil lands constitute sales of the oil."[1] This Court fully accepted that argument and held that an

[1] Brief for the Commissioner, page 5, *Burnet* v. *Harmel*, No. 26, October Term, 1932.

oil and gas lease gave the lessee "the right to enter upon and use the land for the purpose of exploiting it."[2]

The case at bar turned squarely on the determination that the thing sold was oil and gas in place. (R. 73.)

The Decision Below is in Conflict with Established Bureau Practice.

The respondent's brief (P. 11) states that petitioner's reliance on G.C.M. 2270, VI-2 Cum. Bull. 216 (1937), "is misplaced." It should be noted that the respondent does not say that G.C.M. 2270 does not represent established Bureau policy, but merely says that, if applicable, it would lack the force of a regulation.

The truth is that the Bureau consistently has held, and still holds, that where a lease is placed in escrow conditioned upon the drilling of a well, or the fulfillment of other obligations, all of the incidents of ownership belong to the vendees from the time the lease is placed in escrow. The escrow arrangement is simply to assure the vendors that the conditions will be carried out.

Respondent's brief makes a general statement that the nature and effect of the escrow agreement in G.C.M. 2270 were different than in the case at bar, but fails to state the difference. The fact is that the conditions were much more severe than in this case because, in the transaction referred to in G.C.M. 2270:

1. Several wells, rather than one well, had to be started.

2. Stipulated development of various kinds had to be done.

3. The property had to be maintained unencumbered with liens.

4. Certain payments had to be made out of oil produced from the property.

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[2] 287 U. S. 103, 111.

Despite all of the foregoing, the General Counsel of the Bureau held the vendees had "every right of ownership." Under the rule of the case at bar, the vendees would have owned nothing until all of the conditions of the escrow agreement were complied with.

An effort is made to muddy the waters by stating[1] "It is axiomatic that where a written instrument is executed and placed in escrow for delivery at a future date on the performance of a condition, the date of delivery marks the effective date of the instrument." The quoted statement applies only when no rights pass prior to the release of the instrument from escrow. In this case, the taxpayer had the right to enter upon and exploit the land beginning October 6, 1937. The escrow was simply to secure payment for the rights which passed. This is ably pointed out in G.C.M. 2270.

It really is axiomatic that two instruments executed at the same time and referring to each other must be construed together. *Littlefield* v. *Perry*, 21 Wall. (88 U. S.) 205, 220. That rule should be followed in this case.

The Decision of the Court Below is in Conflict with the Established Law and Practice of the Oil Industry.

The respondent's brief is silent on petitioner's argument that the reasoning of the Court below is in conflict with the established law and practice of the oil industry. Petitioner's petition, at pages 10 and 11, clearly shows that such is the fact.

The Cases Cited by Respondent (p. 7) to Sustain the Contention that "to Hold Property is to Own it" Are Not Oil Cases and All Are Clearly Distinguishable on Their Facts.

Respondent's brief does not cite a single oil, gas or mineral decision to support his position. This is true because the decisions listed in the petition sustain petitioner's posi-

[1] Footnote, page 11, respondent's brief.

tion and cannot be distinguished. All the cases cited by respondent are easily distinguished and have no bearing on an oil and gas transaction.

McFeely v. *Commissioner*, 296 U. S. 102, is discussed at page 12 of the petition. It decides that property acquired through intestacy is held, for capital gains purposes, from the date of decedent's death, and not from the time legal title passes through distribution. The case supports petitioner's position.

Helvering v. *San Joaquin Co.*, 297 U. S. 496, involved an option to purchase land in fee. No option is involved in this case.

Shillinglaw v. *Commissioner*, 99 F. (2d) 87, involved a contract to purchase stock, with the seller to have thirty days within which to deliver, and the buyer was not compelled to accept if the surplus as shown by an examination was less than a represented amount.

Commissioner v. *C. A. Sporl & Co.*, 118 F. (2d) 283, involved a situation where the taxpayer, in settlement of a debt due it, received, on October 13, 1931, $14,235.50 cash and an agreement and understanding that the debtor would issue $56,700.00 in second mortgage bonds. The bonds were issued in February, 1932. The Fifth Circuit held the bonds were owned from October 13, 1931. This case definitely supports petitioner's position that rights, and not legal title, should prevail.

In *Shattuck* v. *Helvering*, 119 F. (2d) 902, the question was when a bailment ceased.

Sommers v. *Commissioner*, 63 F. (2d) 551, involves a situation where certain stock was subscribed for, but "that agreement was binding on the subscribers, but not on the corporation." In view of that situation, the Court properly held that ownership of the stock began when the stock was actually issued.

Commissioner v. *Cummings,* 77 F. (2d) 670, involves a situation where a taxpayer acquired option warrants to purchase stock. The Court held ownership of the stock dates from the date of the acquisition of the stock, and not from the date the option warrants were acquired.

Bothwell v. *Commissioner,* 77 F. (2d) 35, likewise involves an option to purchase stock. Ownership was held to date from the date the stock was acquired as a result of the exercise of the option.

Conclusion.

For the reasons stated in the petition and in this reply, the writs should be granted.

ROBERT ASH,
Munsey Building,
Washington, D. C.,
Attorney for Petitioner.

April 26, 1944.